No. 2588

In the

United States Circuit Court of Appeals

For the Ninth Circuit

M. A. MILLER, Collector of Internal Revenue for the District of Oregon, and DAVID M. DUNNE,

Plaintiffs in Error,

vs.

SNAKE RIVER VALLEY RAILROAD COMPANY, a Corporation,

Defendant in Error.

Brief of Plaintiffs in Error

Upon Writ of Error to the District Court of the United States for the District of Oregon.

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STATEMENT OF FACTS.

This action was brought by the Snake River Valley Railroad Company, defendant in error, against the present and ex-Collectors of Internal Revenue for the District of Oregon, plaintiffs in error, in the District Court for the District of Ore-

gon, for the recovery of $870.70, corporate income tax assessed and paid by the Railroad Company to the United States under the provisions of Section 38 of the Act of August 5, 1909, generally known as the Corporate Income Tax Act. The taxing year for which this tax was paid is that of January 1, 1910, to December 31, 1910, inclusive.

The answer filed on behalf of plaintiffs in error was, upon demurrer, held insufficient by the District Court, with the usual time accorded under the rules to amend. Amendment, which would so strengthen the answer as to meet the objections of the court, was impossible. A formal election of the Collectors to stand upon their first answer was, therefore, filed; whereupon the Railroad Company moved for judgment upon the pleadings. This writ of error issued upon judgment so rendered.

From the pleadings filed in the cause, it appears that the Snake River Company was, during the taxing year in question, a corporation organized and existing under the laws of the State of Oregon, and the owner of a line of railroad extending from Wallula, Washington, to Grange City, Washington, with the necessary equipment for the operation thereof, and that prior to the taxing year in question and during the year of 1907, this line of railroad, and equipment and connected property, was leased for a short term to the Oregon Railroad and Navigation Company. The lease to this lessee company is made a part of the pleadings and record. By the terms

thereof, the lessee agreed to pay to the lessor, as rental for the railroad and other property leased, the sum of $70,000 per annum, together with such additional sum as would amount to six per cent interest upon all expenditures made by the lessor, after execution of the lease, on account of additions or improvements to road or equipment. During nearly all of the year of 1910, the lessee was in possession and operation of the leased property under the terms of this lease.

Early in 1911, the Snake River Company made its report to the then Collector of Internal Revenue, showing a net income during the taxing year of 1910 of the sum of $92,070. The source of income over and above the agreed annual rental of $70,000 is not disclosed. From this amount the Collector deducted the statutory exemption of $5,000 and assessed against the Snake River Company a tax of one per cent of the balance. It is admitted that this tax was paid by the defendant in error under protest, and that before the institution of this action to recover the tax so assessed and paid, defendant in error complied with the statutory requirements of application to the Commissioner of Internal Revenue for the refund of the tax collected. It is contended on behalf of plaintiffs in error that the imposition of the tax in question, and the collection thereof, was justified by reason of the fact that during the tax year in question the Snake River Company engaged in a sufficient doing of business in

its corporate capacity to bring it within the purview of the corporate income tax act mentioned.

It is alleged in the answer in this case, and by the demurrer admitted, that during the greater portion of the tax year mentioned, defendant in error was the owner of the line of railroad in its complaint described, with rolling stock and equipment necessary to the operation thereof; that during the year in question this company maintained general offices in the City of Portland, Oregon, and during that time maintained its corporate existence by the holding of stockholders' meetings, and the election thereat and appointment thereafter, to its various offices, of corporate directors and officers, who, on behalf of the corporation, were engaged in collecting the income and rents accruing by virtue of the lease of its property and otherwise; in the making of transfers of stock of the corporation; and in the management of the finances and invested funds thereof; and that during the taxing year mentioned, in addition to the usual and routine business of the Snake River Company, and through the agency of its lessee, and in accordance with the terms of its lease, it engaged in the construction of certain new warehouse railroad tracks, and of other railroad tracks connecting the line of railroad of the Snake River Railroad Company with the line and road of the North Coast Railroad Company; that it also constructed in the manner aforesaid a stock and cattle passageway thereunder or

thereover; that, before the expiration of the taxing year, it was determined by the stockholders and officers and directors of the Snake River Company that the lease theretofore made of its property should be canceled, and the property sold; that during the taxing year in question this lease was canceled (the lease itself providing for cancellation by either party thereto upon thirty days' notice to the other, but in this case cancellation being reached in less time by written agreement); that immediately after the cancellation of the lease, and on date of December 23, 1910, and during the tax year, the entire railroad, plant and equipment of defendant in error was sold; that on the same day, the proceeds of such sale, in the amount of over two million dollars, were received by the Snake River Company; that prior to the closing of the taxing year, the Snake River Company, out of the proceeds of such sale of its property, paid its total bonded indebtedness in the amount of a million and a half dollars, and retired the bonds representing the same; that prior to the close of the taxing year, and out of the proceeds of the sale of its said property, the defendant in error company repaid to other railroad companies considerable sums of money theretofore advanced to defendant in error by these other companies on account of construction work by defendant in error undertaken; and that, with other business done and transacted by defendant in error company during the taxing year in question, was the payment of state annual cor-

porate license taxes; the maintenance of offices; the carrying of accounts in bank; and depositing therein and withdrawing therefrom from time to time of sums of money; and generally all such acts as are usual and necessarily incident to such transaction of the business as is pleaded in this answer. The answer further alleges all of the business of defendant in error so transacted within the tax year to have been done within the corporate rights and charter powers and privileges of this company.

These acts of defendant in error were held by the court an insufficient doing of business to bring the defendant in error within the purview of the tax law mentioned. No question is raised of the correctness of the amount of tax imposed and collected. The only question presented is, whether or not the answer alleges a sufficient doing of business by defendant in error, in its corporate capacity, and during the taxing year of 1910, to warrant the imposition of any tax under the provisions of the Act of August 5, 1909.

POINTS OF LAW AND AUTHORITIES.

I.

The amount of business done is immaterial. The doing of any business with the advantages which inhere in corporate organization brings the corporation within the terms of the Act of August 5, 1909. The Snake River Company was "engaged

in business'' and was therefore subject to the Federal Corporation Tax.

Flint vs. Stone Tracy Company, 220 U. S. 107.

McCoach vs. Minehill Railway Company, 228 U. S. 295, 310.

II.

The so-called lease made by defendant in error company to its lessee is in effect a contract of agency only, and does not include the franchise to operate the line of railway demised. Under the terms of this contract, or agreement, the lessee company must be held to have operated as the agent of the owner, in which event the owner company is liable for the corporate tax assessed and collected.

McCoach, Collector, vs. Minehill Railway Company, 228 U. S. 295, 304.

ARGUMENT.

I.

It is not to be expected that the appellate courts would have decided a case in which the facts were so identical with those here involved as to be decisive of the case at bar, although the question of what constitutes being "engaged in business" has been before the Federal appellate courts in a number of cases. Probably the leading case upon that question is that of McCoach, Collector, vs. Minehill Railway Company, decided by the Supreme Court

April 7, 1913, and reported in 228 U. S. at pages 295-312. The Minehill Railway Company case came to the Supreme Court some time after the case of Flint vs. Stone Tracy Company (220 U. S. 107), and the cases therein joined for trial, including what are commonly known as the Real Estate Cases; and also subsequent to the case of Zonne vs. Minneapolis Syndicate (220 U. S. 187). The decision of the United States Supreme Court in the case of Flint vs. Stone Tracy Company is given almost entirely to the determination of the constitutionality of the corporate income tax law and sheds but little light upon the question of what is to be deemed a sufficient doing of business, within the meaning of the income tax law, to bring a corporation within that act. Such part of the opinion of the court as was given to this question in the decision of this case is found at 220 U. S. 169-170 and 171. At page 171, the court, speaking through Mr. Justice Day, say:

> "What we have said as to the character of the corporation tax as an excise disposes of the contention that it is direct, and therefore requiring apportionment by the Constitution. It remains to consider whether these corporations are engaged in business. 'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict., 158, citing People vs. Commissioners of Taxes, 23 N. Y. 242, 244. 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dictionary, Vol. I, p. 273.

"We think it is clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, or leasing ore lands and collecting royalties, managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law.

"Of the Motor Taximeter Cab Company Case, No. 432, the company owns and leases taxicabs, and collects rents therefrom. We think it is also doing business within the meaning of the statute."

Flint vs. Stone Tracy Company, 220 U. S. 107-171.

The opinion of Mr. Justice Day, of the Supreme Court, in the case of Zonne vs. Minneapolis Syndicate, which case was decided concurrently with that of Flint vs. Stone Tracy Company, *supra*, follows the report of the Minehill Railway Company case and is found at 220 U. S. 187-191. In the latter case the court held that the Minneapolis Syndicate was not so engaged in business as to be subject to tax. It is not believed that the Zonne case is here in point, for the reason that in that case a long term lease, amounting practically to a sale of the property, had been negotiated, and the holding corporation against which the tax was laid had so amended its articles of incorporation and charter as to preclude it from any business other than a mere holding of the investment and a distribution

of the income therefrom and of the proceeds of the property held in event of sale.

Following, as it did, the Stone Tracy case, and the Zonne case, the one holding that the corporations were engaged in business and the other that the corporation was not, the Minehill Railway Company case proved a hard one, and was decided by a divided court, with a vigorous dissenting opinion by Mr. Justice Day, who had theretofore written the opinion of the court in both the Stone Tracy and Zonne cases, and in whose dissenting opinion Mr. Justice Hughes and Mr. Justice Lamar joined. By reason of the conversance of Mr. Justice Day with the questions involved, naturally consequent to his labors in connection with the two former opinions of the Supreme Court written by him, it is submitted that his dissenting opinion is worthy of note, and while not claimed as authority, may furnish a line of reasoning helpful in the present case. It is apparently determined that the amount of business done by the corporation taxed is utterly immaterial, provided the business is done in a corporate capacity by the corporation, and within the terms of the act. In this connection Mr. Justice day, in 228 U. S. at page 310 (dissenting opinion), says:

> "We are therefore brought to the direct question, Is a live corporation which, though it has leased its railroad property for a term of years, maintains and has agreed to maintain its corporate organization, collects and dis-

> tributes an annual rental of $252,612 keeps and maintains an office and an office force at large expense, deposits money upon interest and receives and distributes the earnings thereof, invests a large fund which, together with interest on deposits, yields over $24,000 a year, doing business within the meaning of the Corporation Tax Act? The amount of business done is utterly immaterial. The doing of any business with the advantages which inhere in corporate organization brings the corporation within the terms of the act. Such was the ruling in the Flint case after full consideration by this court of the terms and scope of the law."

It is contended by the defendant in error company that the case at bar is governed by the decision in the Minehill Railway Company case, *supra*, and such was the holding of the district court. The collectors, plaintiffs in error, contend that there are decided points of difference between the Minehill Railway Company case, and that here before the court. It will hardly be contended that the decision of the United States Supreme Court in the Minehill Railway Company case would have been the same, had there been shown any doing of business by that company in addition to that done by them as appears from the report in this case. In other words, it is submitted that the Supreme Court, in the Minehill Railway Company case, went to the extreme in holding the activities of that company without the purview of the corporate income tax act. If, therefore, we are able to distinguish that case from the one here before the court for decision, and to show a much greater corporate business activity on

the part of the Snake River Company than is shown in the record of the Minehill Railway Company case, it is believed that the judgment of the district court must be reversed.

The record of the Minehill Railway Company case discloses that that company, prior to the taxing year, leased its entire railroad, with side tracks, extensions, appurtenances, rolling stock and personal property, for a term of 999 years, at an annual rental equivalent to six per cent upon the capital stock of that company. This lease was to all intents and purposes and in effect a sale of the property of the lessor company. In the case at bar the lease from the Snake River Company to the lessee railroad is in striking contrast and requires particular notice. It runs for a term of but five years from July 1, 1907, and would have expired by limitation shortly after the close of the taxing year. It is apparently drawn with a view to constant association of the lessor and the lessee in the maintenance, improvement and additions to the railway system of the lessor. Paragraph II of the lease provides that the lessor shall be paid, in addition to the annual rental of $70,000 reserved,

> "an additional sum equal to interest payable during the half year next preceding such rent at the rate of six per cent per annum upon all expenditures made after the date hereof for the purchase by or on account of the lessor, of locomotives, cars and other equipment for use upon or in connection with the railroad hereby leased, or for the construction or acquisition of

extensions, branches, terminals or additions to or betterments of the demised premises."

The fourth paragraph of the lease likewise provides for the repayment by the Snake River Company to its lessee of sums advanced by the lessee at the request of the Snake River Company, or necessarily expended by the lessee for additions or betterments to the leased premises or for the purchase of equipment, together with six per cent interest thereon from the date of such expenditures. In the Minehill Railway Company case, the lessor company, during the taxing year, did nothing in the way of operation of its railroad line or additions to line or equipment. In the instant case it is alleged and admitted that the Snake River Company, by the agency of its lessee, constructed an additional line of railroad whereby the line of that company was connected with the line and road of the North Coast Railroad Company, and not only so constructed the connecting track of railroad mentioned, but in addition thereto laid and constructed certain warehouse railroad and side tracks and placed thereunder or thereover a stock and cattle passage way at a cost to the Snake River Company of almost $1,000.

In the Minehill Railway Company case, the 999 year lease entered into continued in force during the entire term of the taxing year. In the instant case the short term lease demising the property of the Snake River Company was canceled before the

expiration thereof; that cancellation being instituted by the officers of the Snake River Company in accordance with the terms of the lease, and subsequently effected by formal written agreement entered into between both parties to the lease. The lease was canceled December 23, 1910, within the year for which the tax here contested was laid. On the same day, a sale of the property theretofore demised was made by the Snake River Company, and formal deed of conveyance covering said property executed and delivered to the purchaser; in consideration of which conveyance the Snake River Company received the proceeds of said sale in the amount of $2,225,000. As alleged in the answer of the collector, and admitted by the demurrer, a considerable portion of this money so received from the sale of the property of defendant in error was disbursed by the Snake River Company during the taxing year in question, one and one-half millions of dollars going to the payment of the bonded indebtedness of that company, and the retirement of the bonds representing this indebtedness, and other payments being made to other railroad companies on account of funds advanced to the Snake River Company for construction purposes. In both the Minehill Railway Company case and the case here in question the railway companies each held stockholders' and directors' meetings, elected officers, made corporate reports, made collections of rentals and interest charges, maintained active accounts in

bank, managed the corporate finances, paid taxes, maintained offices, and transferred shares of stock.

The United States Supreme Court has held that the tax provided by the Act of 1909 is not measured by the amount of business transacted. A corporation engaged in business may do a great amount of business, and if no net income results, that corporation is not subject to payment of any tax under the provisions of this act. On the other hand, a corporation engaged in business may transact but one business deal during an entire year, and make a large net gain by reason thereof, one per cent of which, after deducting the $5,000 exemption provided by statute, must be paid to the Collector of Internal Revenue, under the provisions of this statute. Neither can the *right to tax* be governed by the amount of business transacted. Let us suppose that the Snake River Company was one organized and incorporated for profit under the corporation laws of Oregon, for the purpose of buying, owning and selling timber lands; and prior to the year 1910, had accumulated a large tract of such lands. Let us assume that the market for timber land during the year 1910 was stagnant; and that, in order to curtail maintenance expense, this company, as is the practice of owners of large timber tracts, had, in 1909, leased its timber lands to a stockman for grazing purposes. Now, let us assume that, on December 23, 1910, the Snake River Company procured a purchaser for its entire timber holdings, and consummated a sale thereof at a

large profit to the selling company. In this hypothetical case, does any reason prevail for exempting the Snake River Company from the provisions of the corporate income tax act? If not, why should the company be exempted, because, instead of owning and selling two and one quarter million dollars worth of timber lands, it owns and sells the same amount of railroad?

It should be likewise noted that every act of the Snake River Company corporation, during the taxing year in question and above mentioned, was done, not for the purpose of enabling the lessee to enjoy its rights under the lease, but for the direct benefit of the lessor company. The building of increased trackage presumably added to the value and efficiency of this company's line of road. The sale of its properties was presumably an advantageous one. The company was organized for profit, and all of its corporate activities during the taxing year of 1910 were within the corporate charter powers of this company, and within the ordinary scope of the business of a company organized for the purposes for which the Snake River Company was organized and incorporated. No court has in any reported decision gone so far as to hold that a corporation may be engaged in business to the extent of that transacted by defendant in error company and successfully plead such corporate inactivity as to remain without the purview of the corporate income tax act of 1909. It is respectfully submitted that if the facts in the Minehill Railway

Company case were such as to compel the opinion of but a bare majority of the United States Supreme Court that the company was not "engaged in business" within the meaning of this act, the facts in the case at bar, so much more conclusively showing a doing of corporate business within the taxing year than did those in the Minehill case, compel a decision against the defendants in error, and reversing the district court.

In the decision of the case of McCoach vs. Minehill Railway Company, *supra*, much consideration is given to the fact that this company maintained a so-called "contingent fund," the investment of which returned an item of income of approximately $24,000 during the taxing year. It should be noted in the instant case that the return of the Snake River Company to the Collector of Internal Revenue shows a net income, during the taxing year of 1910, of $92,070. The rental of the line of railroad of the Snake River Company, reserved in the lease, is of the amount of but $70,000 per annum, with provision for interest upon cost of improvements in equipment and line, which, during the year in question, could have amounted to not more than some hundreds of dollars. The source of that portion of the income of this company for 1910, over and above the $70,000 provided for by the lease of the Snake River Company's railroad line and equipment, and amounting to approximately $22,000, is not disclosed by the record, but it becomes apparent that the Snake River Company, during the taxing

year of 1910, had some source of income other than the lease of its line of railroad and equipment, so in this respect, it would appear that there is no difference between the case of the Minehill Railway Company and that here before the court. In fact, there appears to be no form of corporate activity found in the record of the Minehill Railway Company case which is not presented in the record of the case here for decision. In addition thereto, there is much in our case in the way of corporate business activity during the taxing year which is totally absent from the Minehall case mentioned. Counsel for the plaintiffs in error is convinced that, had the facts in the Minehill Railway Company case, when that case was before the Supreme Court, been those found in the case here presented, the United States Supreme Court would have reached a different decision, and that, upon a full consideration of the record in our case as the same discloses a doing of business by the Snake River Company during the taxing year of 1910, the decision of this court must, upon this issue alone, be for plaintiffs in error.

II.

In the majority opinion of the court in the Minehill Railway Company case, and at 228 U. S. 304, the court, in speaking of the lease demising the line of railroad and equipment and property of the Minehill Company, say:

> "If that lease had been made without authorization of law, it may be that for some purposes, and possibly for the present purpose, the lessee might be deemed in law the agent of the lessor; or at least the lessor held estopped to deny such agency. But the lease was made by the express authority of the state that created the Minehill Company, conferred upon it its franchise, and imposed upon it the correlative public duties. The effect of this legislation and of the lease made thereunder was to constitute the Reading Company the public agent for the operation of the railroad and to prevent the Minehill Company from carrying on business in respect of the maintenance and operation of the railroad so long as the lease shall continue. And it is the Reading Company, and not the Minehill Company, that is 'doing business' as a railroad company upon the lines covered by the lease and is taxable because of it."

The lease of the line of railroad and property of the Minehill Company, which was made to the Reading lines, as appears from page 297 of the report, included

> "All the rights, powers, franchises (other than the franchise of being a corporation), and privileges which may now, or at any time hereafter during the time hereby demised, be lawfully exercised or enjoyed in or about the use, management, maintenance, renewal, extension, alteration, or improvement of the demised premises or any of them."

It also appears from the report of the Minehill Railway Company case that this lease of the Minehill Company property and franchises was authorized under general acts of the Pennsylvania State

Legislature, and that a use, therefore, of the franchise granted to the Minehill Railway Company to operate its lines of railroad, was lawfully demised to its lessee.

Here, again, the Minehill Company case may be distinguished from that at bar. It will be noted from an examination of the lease demising the line and equipment of the Snake River Company to its lessee, that no demise is made therein of the franchise of this company. We refer, not to the *primary* franchise of the Snake River Company to be a corporation, but to the *secondary* franchise of that company to operate carriers and handle traffic over its railroad and right of way. The lease to this lessee simply covers the railroad property, e. g., tracks, cars, depots, engines, etc. In the absence of any demise or grant of the secondary franchise, the lessee could not lawfully operate trains and carry traffic over this right of way, except as the agent of the lessor. Now, it cannot be assumed that the lessee was operating unlawfully, and the only way it could operate lawfully, in the absence of a grant or demise in the lease of the secondary franchise, was as the agent of the Snake River Company, the lessor. That being the case, the holding of the Supreme Court in the Minehill case, as to the liability for the tax where the lessee operates as the agent of the lessor, becomes strictly applicable to our case. In the Minehill Railway Company case it is distinctly intimated that, if there was no

legal authority for the lessee to operate the railroad lines, it would then be considered a mere agent of the lessor in the operation thereof. This would be much more the case where the lease itself did not even purport or attempt to grant to the lessee the right to operate the railroad, as is true in our case; and in this case, it is submitted that this lease, in its present form, operated as nothing more nor less than a working agreement between the Snake River Company and its lessee, whereby the Snake River Company operated its line of railroad and equipment through the agency of the lessee. This view is strengthened by reason of the close association constantly required under the terms of this lease between the Snake River Company and the lessee, provided for in paragraphs II and IV of the lease.

Upon the whole record, it is respectfully submitted that the judgment of the district court must be reversed.

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